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The EU's Common Agricultural Policy at Fifty

An International Perspective

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The Common Agricultural Policy (CAP) of the European Union played an important – if controversial – role in the political integration of Europe fifty years ago.[1] It assisted the agricultural sector's contribution to the economic reconstruction of the continent in the post-war period by sheltering it from external competition with high barriers at the borders and from internal rationalisation by extensive market management. The CAP, born of painful political compromise, proved an inflexible instrument for the encouragement of modern agricultural. Costs continued to grow relative to benefits throughout the 1970s and beyond. Costs were imposed not only on EU consumers, taxpayers and non-agricultural industries but also, through its depressing impact on international food prices, on farmers in many other parts of the world.

Starting in the early 1990s, the CAP evolved in a significantly different direction. The policy was changed in a way that reduced somewhat its perverse incentives for overproduction of undifferentiated farm products for which demand has been stagnant. The 1992 reforms, followed by further changes in 1999 and 2003, shifted the main focus of support in two important ways: to direct payments which were less distortionary, and to the encouragement of the production of higher quality food for which affluent consumers in Europe and abroad were prepared to pay a premium.

Even so, large questions remain. Have the reforms since 1992 resolved the underlying issues of overprotection of European agriculture? Has the successive enlargement of the EU merely spread a protectionist blanket over more of the Continent?

Europe is by no means alone in supporting agriculture well beyond the modest levels that might be warranted by the external benefits of softening adjustment costs, stabilising markets for foodstuffs or providing ecological goods and services. How does Europe stack up against other industrial countries that have faced similar problems of structural adjustment and similarly made significant transfers to their farm sectors? Is the CAP still excessive and out-of-line with the policies of its trading partners?

The rate and value of farm support

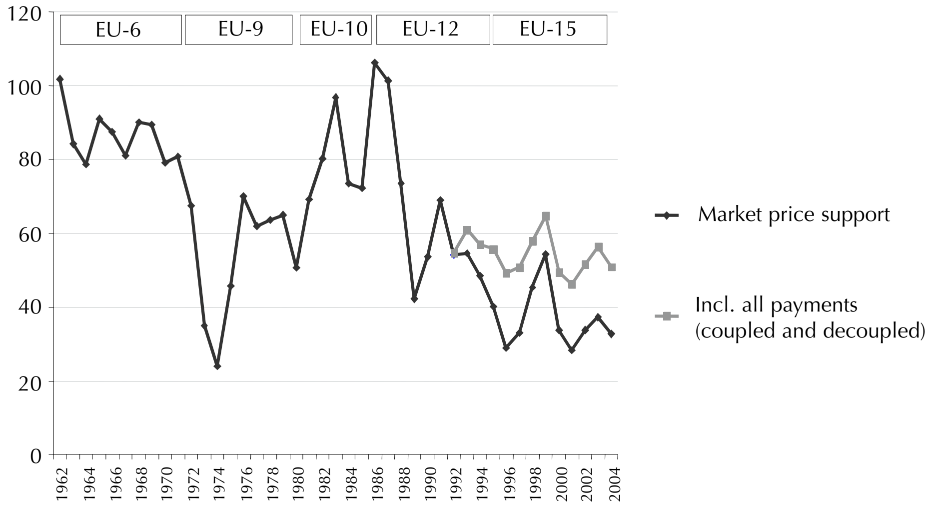
A forthcoming study by the World Bank has made it possible to address these questions with credible and consistent estimates of the rate of assistance to farmers since the 1950s, both absolutely and relative to assistance to producers of non-farm tradables.[2] The results give a picture of the level of assistance given to EU agriculture over time, a comparison between the EU and non-EU members in Western Europe, and between North America, Northeast Asia and Australasia. This Policy Insight summarises some of the results of this study as a contribution to the assessment of the first half-century of the CAP.

Three indicators of levels of support afforded EU agriculture since 1962 (when the EEC's CAP became operational) are worth focusing on. The first, shown in Figure 1 on an annual basis, expresses support in *ad valorem* terms as a nominal rate of assistance (NRA), measured as a percentage of the border price or undis-

1 This note is based on a seminar presented by Anderson at CEPR in London, 31 May 2007. An earlier version was presented by Josling at a Dutch Government seminar in The Hague, 19 April 2007. Support by those organizations and financial assistance from World Bank Trust Funds, particularly from DfID and BNPP, are gratefully acknowledged, as is the research assistance of several people including Esteban Jara, Ernesto Valenzuela and Uli Kleinwechter. Views expressed are the authors' alone and not necessarily those of the World Bank or its Executive Directors.

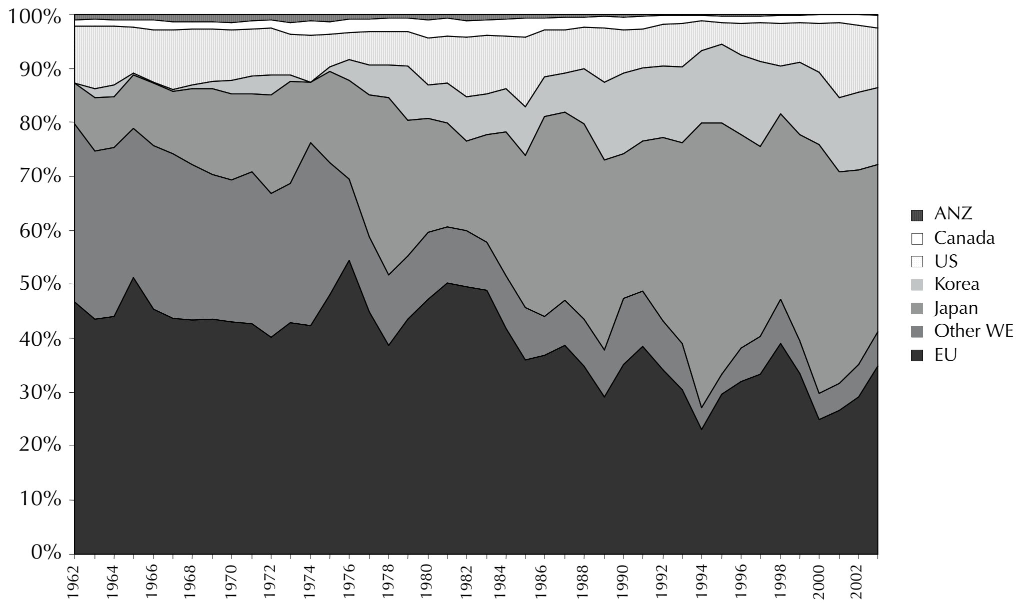
2 The study itself covers more than 70 countries, including most of the major developing countries. Details including the methodology paper can be found at www.worldbank.org/agdistortions, pending the publication next year of the book edited by Anderson (2008) which contains the Western European chapter by Josling and is the source of the three figures in this paper.

Figure 1 Nominal rate of assistance to agriculture, EEC/European Union, 1962 to 2004 (percent)



Source: Anderson (2008).

Figure 2 Shares of aggregate nominal assistance to all OECD agriculture, EEC/European Union and other high-income country groups, excluding decoupled payments, 1962 to 2004 (percent)



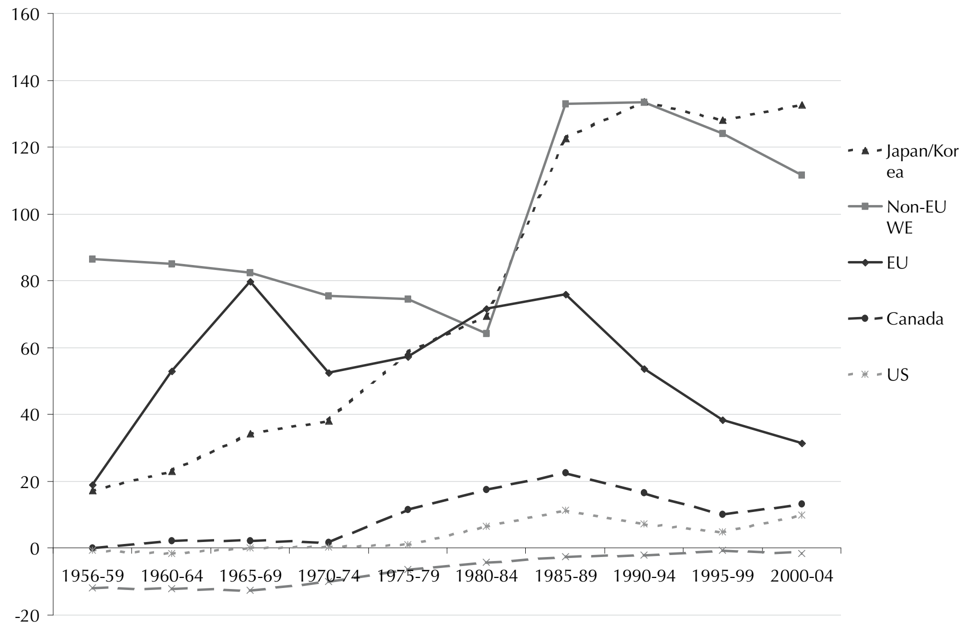
Source: Anderson (2008).

torted value of revenue.[3] Several features are clear from that figure, in which dates of increase in EEC/EU membership are indicated at the top. One is its cyclical nature, generated by variable import levies and export subsidies that were aimed at reducing shocks to internal prices when international prices were high (1973-74, the early and late 1980s, 1995) or low (early 1960s, mid-1980s). Another is the policy break in 1992, when some payments began to be more direct rather than provided as price supports and hence are somewhat decoupled from production. Third, there appears to be a downward trend in the *ad valorem* rate of assistance via price support. But fourth, if the extent of decoupling of those direct payments is only modest (so the upper line from 1992 is closer to reality), and if the high level of support in 1962 is ignored, the pace of that decline in the *ad valorem* rate of support is only very slight over the past 40 years.

To compare directly the overall aggregate level of support to EU farmers relative to farmers in other OECD countries, a comment is needed on the degree of decoupling associated with different forms of direct payments (i.e. support other than through the market). Direct payments in the United States under the 1996 FAIR Act, for example, were still commodity specific, but they relate to historical base acres per farm rather than current production. The 2002 US Farm Bill added

3 The NRA is distinct from the OECD's 'producer support estimate' or PSE, which presents support as a percentage of the assistance-inclusive price and so is always lower than the NRA. These new NRA estimates go back to 1962 when the EEC's CAP came into being, whereas the OECD's PSEs begin only in 1986. Although we have drawn on OECD data, that organization is in no way responsible for any of our results or their interpretation.

Figure 3 Relative rate of assistance to agriculture, EEC/European Union and other high-income country groups, excluding decoupled payments, 1956 to 2004 (percent)



Source: Anderson (2008).

counter-cyclical payments which the US argues are also not commodity-specific, but which almost certainly are less decoupled than the previous Act's direct payments. But meanwhile the US Conservation Reserve program continues to keep land out of production and so probably more than offsets any production-expanding effects of the direct and counter-cyclical payments. The 1992 MacSharry compensation payments in the EU were also linked to historical production patterns, but with the requirement that land still be used in agriculture. The EU's Single Farm Payments (introduced in 2003 but not yet fully implemented) relaxes this constraint somewhat, but still requires 'cross-compliance' with environmental standards. For current purposes, we simply assume that direct payments under the 1996 FAIR Act and the counter-cyclical payments under the 2002 Farm Bill are both fully decoupled in the United States (drawing also on evidence in Goodwin and Mishra, 2006). Direct farm payments from 1992 to 2002 in the EU, and to a lesser extent those under the EU's single farm payments program from 2003, are arguably less decoupled though (see Thompson, Dewbre and Martini, 2007), so we show their impact separately in Figure 1.

With these caveats, we are able to compare the aggregate values of price-distorting assistance across high-income countries, as in Figure 2. From that figure it is apparent that, with the downward trend in the nominal *ad valorem* rate of assistance in the EU and its rise in other Western European and Northeast Asian economies, the EU's share of the total value of assistance fell over the period to 2004 despite the EU absorbing new members who had, on average, lower rates of assistance prior to acceding. In the early 1960s its share was half of all OECD assistance, by the latter 1970s it was two-fifths, and by the first half of the present decade it was only around one-third. However, had 'decoupled' support been included, the EU share in the past ten years would be close to one-half, suggesting no decline since the 1960s. And now that share would be even larger following the accession of twelve new members (ten in mid-2004 and two on 1 January 2007).

Our third indicator is the relative rate of assistance (RRA), which takes into account assistance to producers of non-agricultural tradables as well.[4] As with the NRA, the RRA calculation draws on data from OECD and Eurostat sources. Five-year averages are reported in Figure 3 to show more clearly the trends in support for farmers relative to non-farm producers (again ignoring the EU's decoupled payments). That indicator is shown not only for the EU but also for other OECD countries, and back to the mid-1950s.

Figure 3 shows that the EEC and other Western European countries[5] start the period with the highest levels of assistance. They had similar and slightly declining RRAs from the mid-1950s up to the early 1980s, while Japan and Korea converged from below to those rates during that period. By then policies were favoring agriculture over non-agricultural tradable sectors by 60 or more percentage points. Meanwhile, North America and Australasia raised their RRAs, but from a very low

4 The Relative Rate of Assistance is calculated as RRA = 100[(100+NRAag)/(100+NRAnonag) - 1].

5 The countries in this "non-EU" European aggregate change as the EU enlarges. By the end of the period, only Norway and Switzerland are in that category. Thus changes in the level of protection for this aggregate reflect the change in country composition as well as policy changes. It can be thought of as an average "EFTA" support level.

base. Indeed the RRA averaged less than zero for Australia and New Zealand, because the rate of manufacturing protection there was well above the agricultural assistance rate. Rates rose in all countries in the 1980s in the wake of the agricultural export subsidy war between the EU and North America (which drove international food prices to their lowest level ever in real terms). Since then, RRAs have come down for the EU but also for other OECD countries, although least so for Other Western Europe and Japan and Korea which continued their generous support to agriculture when the EU began to reign in its policies. By the turn of the century, the EU was perched between the stratospheric levels of protection of Japan, Korea, Norway and Switzerland and the rather low levels in Canada and the US, while Australia and New Zealand have unilaterally moved to virtually free markets for both farm and non-farm goods.

The political economy forces driving that assistance

The rate of assistance granted by the CAP reflects both external developments, principally the level of world prices as modified by exchange rate movements, and internal developments, notably enlargement impacts and policy reforms (often linked to budget pressures). More recently, multilateral constraints such as the commitments made by the EU in the Uruguay Round have had a significant impact. The period of high world prices in the early 1970s shows up as a significant decline in the level of support. But the opportunity to reorient the policy towards world markets was squandered over the next decade, as institutional prices were ratcheted up in an agricultural 'scala mobile'. By the mid-1980s, when world prices were low, the CAP had become a major external as well as internal albatross. Price restraints at the end of the 1980s and policy reforms of the 1990s have helped to reverse the trend, and to at least partially reconnect European agriculture to the global market place.

To what extent has the CAP lured new members into its protectionist web? The 'enlargement effect' is mixed. In the 1970s, the UK abandoned its somewhat more liberal agricultural policy, and allowed the EU to delay reform by helping to finance the CAP. Ireland and Denmark enjoyed switching from the lower-priced UK market to the more lucrative Continental market for their export products. In the 1980s, Spain received a boost in agricultural support by adopting the CAP, but Portugal had to reduce many of its prices.[6] When the Nordic and Alpine countries joined, support levels in those countries generally declined, so the CAP can be credited with some restraint on Austrian and Finnish policy.[7] The most recent enlargement has already and will continue to increase both the nominal and the relative rates of assistance in all but the most protective (Slovenia and Romania) of the new EU members (Anderson, 2008).

The 1992 reforms allowed the EU to agree to constraints on spending on export subsidies and on trade-distorting support. The combination of internal policy reform and external commitments under the WTO has changed the trajectory of the CAP. However, the CAP continues to support major unproductive sectors of European agriculture, notably through high levels of border protection. This has helped to frustrate the World Trade Organization's on-going Doha Development Agenda and to embarrass the EU's broader commercial policy agenda.

A key question is whether the path of reform of the EU will continue. It is unfortunate that the opportunity afforded by the Doha Round to eliminate export subsidies and lock in low levels of domestic support (and halve the EU's external bound tariff on farm goods) seems to be slipping away. If the political attraction of the 'new' elements of the CAP, emphasizing quality foods and environmental sensitivities, remains strong, then a reversion to the explicit trade-distorting support of the past is unlikely – although some elements of trade distortion are sure to remain in the form of overly cautious non-tariff barriers ostensibly for food quality and environmental protection.

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6 Greek membership in 1981 had little impact either on the EU or on Greek agriculture, as its production of the main temperate zone products was small.

7 Sweden had reformed its own policy in 1990 and therefore had to undo those reforms on joining the EU.

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